

**AGENDA FOR THE
PENSION REFORM COMMITTEE
MEETING OF
Tuesday, October 21, 2003
4:00 PM – 6:00 PM Meeting**

**401 B Street
Conference Room, 4th Floor**

MINUTES

**THE REGULAR MEETINGS OF THE PENSION REFORM COMMITTEE ARE
SCHEDULED FOR EVERY TUESDAY AT 4:00 PM AT 401 B STREET, 4TH FLOOR**

Item 1: Call to Order

The meeting was called to order at 4:05 PM.

Item 2: Roll Call

<u>Members Present</u>	<u>Members Absent</u>	<u>Staff Present</u>
April Boling	Steve Austin	Patricia Frazier
Robert Butterfield	Tim Considine	Chris Morris
Stanley Elmore	Judith Italiano	Larry Grissom
William Sheffler	Richard Vortmann	Paul Barnett
Kathleen Walsh-Rotto		Mary Braunwarth
		Pam Holmberg
		Dennis Gibson

Item 3: Approval of Minutes

A motion to approve the minutes was made by Mr. Butterfield. The motion was seconded by Mr. Sheffler. The motion was unanimously approved

Item 4: Retirement System Overview

Larry Grissom and Paul Barnett from the City's Retirement Department completed their review of the SDCERS system which was presented at the October 14 meeting. They followed with a presentation on the history, policies, practices and performance of SDCERS Investments. Please see the attached outline of this presentation.

**Item 5: Discussion and Possible Guidance or Action Regarding Upcoming
Presentations related to the Retirement System Overview**

Ms. Boling asked Larry Grissom for an explanation of SDCERS “waterfall” process which guides the distribution of surplus earnings. He agreed to provide that presentation at a future meeting.

There will be no meeting on November 11 because of the Veterans Day holiday. The SDCERS System actuary, Rick Roeder, has agreed to present to the Committee free of charge and is available November 18. Since it appears all Committee members will be in attendance on November 25, that meeting will be utilized to develop a work plan and future schedule.

Item 6: Comments by Committee Chairperson

None.

Item 7: Comments by Committee Members

Mr. Elmore asked for clarification on public communication. He has been invited by the Retired General Membership Association to come speak about the Committee. He asked if he should accept the invitation to speak or if he should refer them to the Chair. Ms. Boling believed it was fine for him to speak to the Association and update them on what the Committee is investigating and learning. If any opinions are expressed it must be from the individual member not from the Committee.

Mr. Butterfield said he would like to have lunch with Rick Roeder (the SDCERS actuary) and discuss the City’s Retirement system. He wanted to make sure it would be appropriate and this wouldn’t be a violation of ethics or the Brown Act. Chris Morris from the City Attorney’s office said this shouldn’t be a violation of either. Mr. Morris recommended that each party pay for their own lunch. Ms. Boling did not see any problem with meeting.

Ms. Walsh asked if the Committee was allowed by the Brown Act to have closed session. Mr. Morris responded that Brown Act allows for closed session, but only for specific reasons such as labor negotiations or litigation. He didn’t think most of the items discussed by the Committee would fall under those parameters.

Item 8: Non-Agenda Public Comment

None.

Item 9: Adjournment

The meeting was adjourned at 5:25 PM.

The next meeting will be on Tuesday, October 28 at 4:00 PM at the same location

SAN DIEGO CITY EMPLOYEES' RETIREMENT SYSTEM



**Presentation to the
Pension Reform Commission on**

**SDCERS INVESTMENTS:
History, Policies, Practices and Performance**

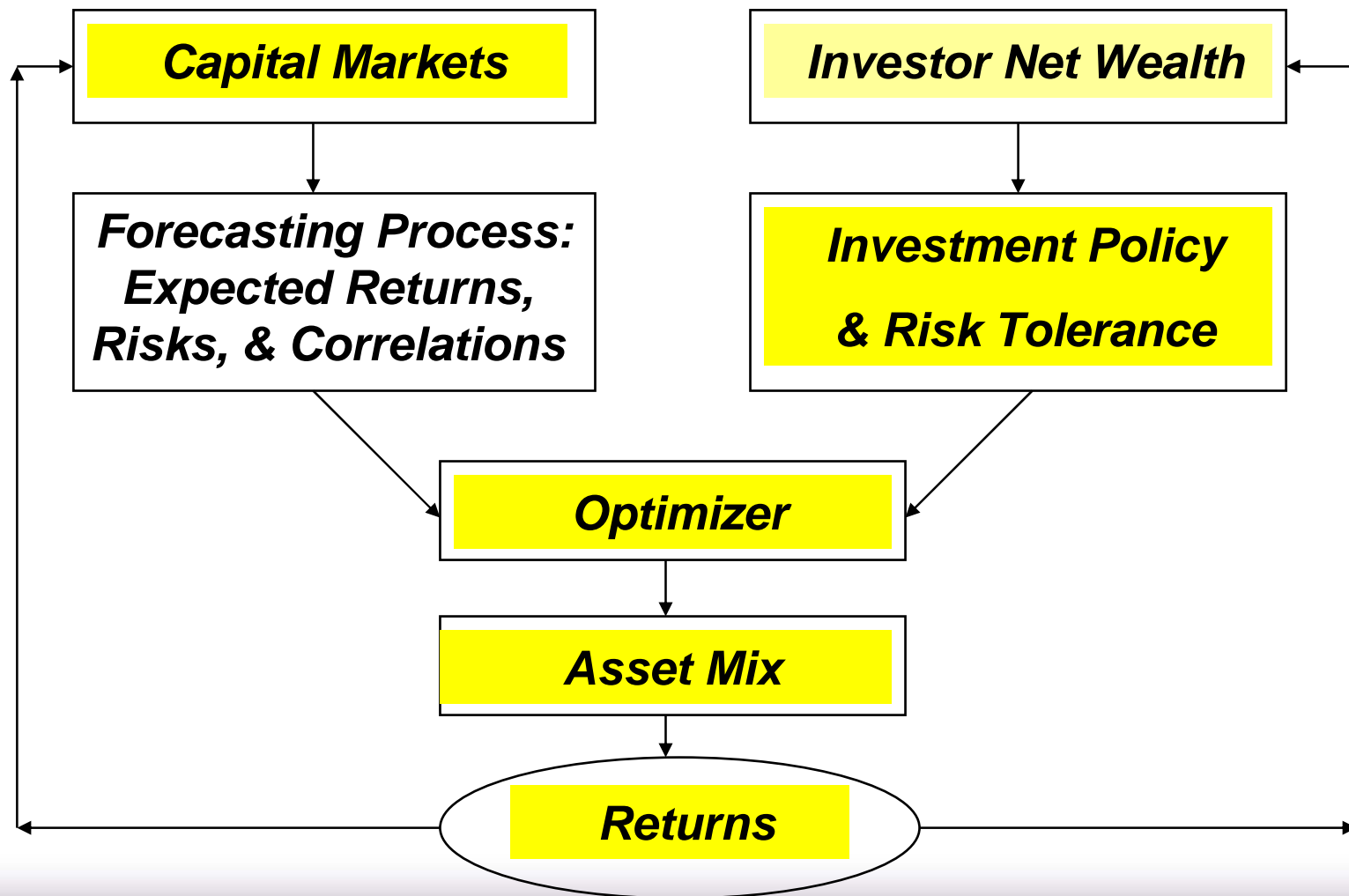
October 21, 2003



Outline of Today's Meeting

- I. Institutional Investing
- II. History of SDCERS' Investment Program and City's Funded Status
- III. Investment Policy Parameters & Oversight
- IV. Administration and Implementation of Investment Strategy
- V. Performance Record
- VI. Summary

The Institutional Pension Investment Process



Pension Investing Differences: Individuals vs. Public Institutions

Factors

- Time Horizon
- Risk exposures
- Risk tolerance
- Cost structure
- Liabilities
- Taxes
- Performance monitoring
- Policy controls

Individuals

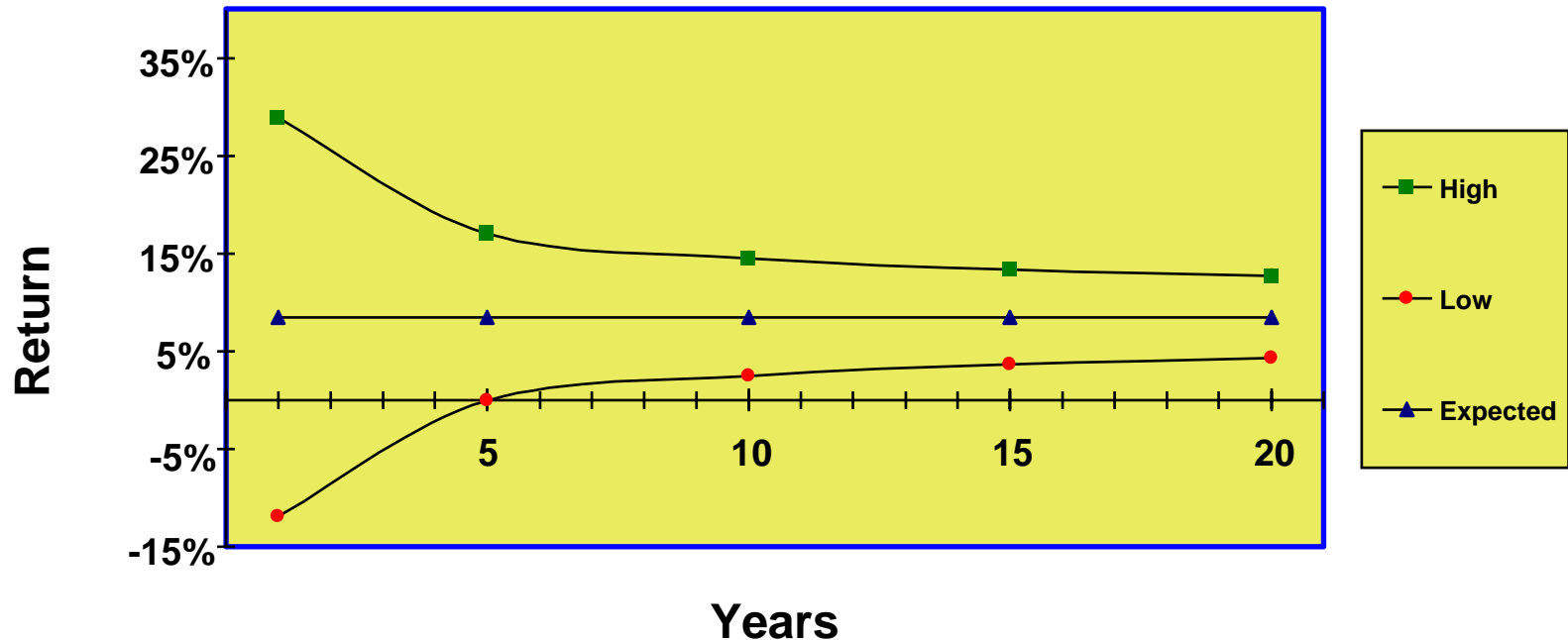
- Finite
- Highly variable
- Too conservative
- Higher retail
- Uncertain
- Some impact
- Ill-timed with adverse outcome
- Ad-hoc

Public Institutions

- Infinite
- Pooled/smoothed
- Moderate
- Lower wholesale
- Pooled/smoothed
- No impact
- Regular and periodic
- Due process with oversight

Benefit of a Long-Term, Institutional Time Horizon: Greater Certainty of Achieving Goals

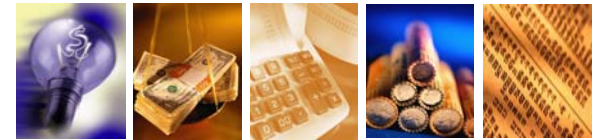
Range of Portfolio Returns Expected with 95% Probability (+/- 2 Std. Dev.)





Historical Background

- City Charter established Retirement System trust fund **separate** from City governmental operations.
- State law limits investment of governmental operating funds to cash and bonds, with a maximum maturity of 5 years.
- In 1984, State law was changed to allow **retirement funds** to invest in stocks.



Historical Background (cont.)

- Prior to 1989, assets were managed for 26 years by one advisor in a balanced mandate.
- In 1988, although long-term performance exceeded the actuarial assumed rate of return, SDCERS ranked near the bottom of the public fund performance universe.
- In 1989, the Retirement Board took a direct, active role in setting the asset allocation strategy and implementing the strategy by hiring multiple specialist managers.

SDCERS' History of City's Funded Status

Progress toward mission of full funding:

- In 1977, 25 years ago, funded ratio = 60.5%
- In 1982, 20 years ago, funded ratio = 75.6%
- In 1992, 10 years ago funded ratio = 95.2%
- In 2002, last valuation, funded ratio = 77.3%



Overview of Investment Policies

- Written Investment Policy and Guidelines based on multiple levels of legal authority:
 - ✓ State Constitution
 - ✓ City Charter
 - ✓ City Council Resolution
 - ✓ SDCERS Board of Administration.

Key California Constitution Policy Elements

- Assets are to managed by the “Prudent Expert” standard.
- Proposition 162 – Retirement Board has “plenary” authority to manage the Trust.

Key City Charter Policy Elements

- Assets are managed by the Board (or can be delegated to the Funds Commission).
- Can invest in securities authorized by General Law for savings banks.
- Can invest in other additional classes or types of assets as approved by City Council Resolution.
- Individual investments must be approved by independent investment counsel hired by the Board.
- Assets are to be held in a Trust Fund.

Key City Council Policy Elements

- No more than 40% of sovereign or solvent corporate debt investments can be non-US.
- No more than 40% of the fund can be invested in real estate (equity or debt).
- No more than 70% of the non-real estate assets can be invested in common stocks.
- No more than 40% of common stocks can be non-US.
- Miscellaneous investments not in the above categories must be approved by the Board upon recommendation by investment counsel.

Key Board Policy Elements

- Approved types of equity and debt securities further identified.
- Diversification insured by limits placed on allowed exposure to various securities.
- Real estate diversified across property types, location, private holdings and publicly traded securities.
- Business risk controlled by limiting amount of SDCERS assets placed in each advisor's investment process.
- Board's custody and safekeeping of assets specified.

Key Board Policy Elements (cont.)

- Board's investment manager selection process specified.
- Board's performance goals, measurement process and quarterly reviews specified.
- Annual review of long-term asset allocation strategy by Board.
- Review of assets and liabilities every three year by Board.
- Delegation to staff to monitor and rebalance asset mix.



Management of Investments

- Assets titled in SDCERS' name.
- Assets held in trust by a Custodial Bank (State Street Bank).
- Only specified SDCERS staff or trustees have signatory authority with the Custodial Bank.
- Expert investment consulting guidance is used for policy formulation and investment strategy setting (Callan Associates and Russell Real Estate Advisors).

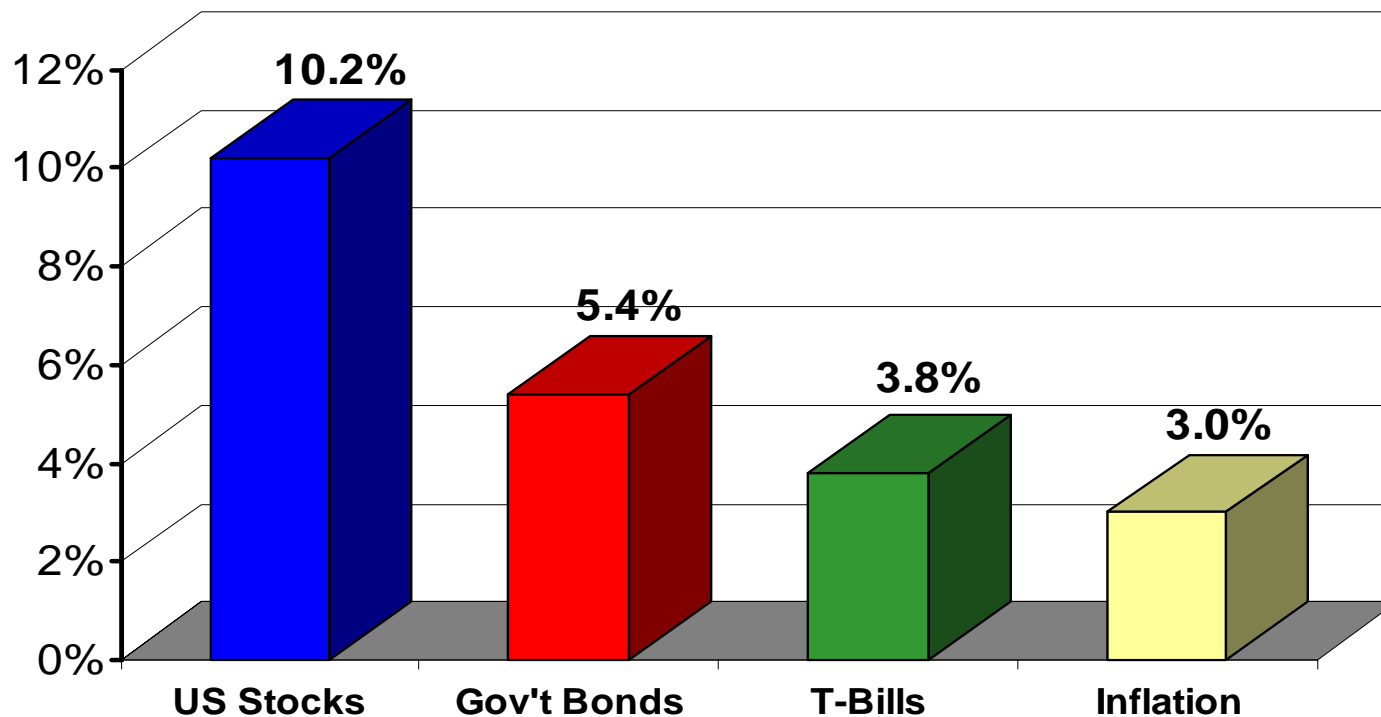


Asset Allocation Process

- Determine approved asset classes.
- Determine policy limits to asset groups.
- Develop capital market assumptions:
 - Expected Returns
 - Expected Risks (volatility)
 - Expected Associations (correlations)
- Optimize the asset mix's expected risk and return trade-offs to maximize the efficiency of the mix.
- Implement strategy, monitor and measure performance.

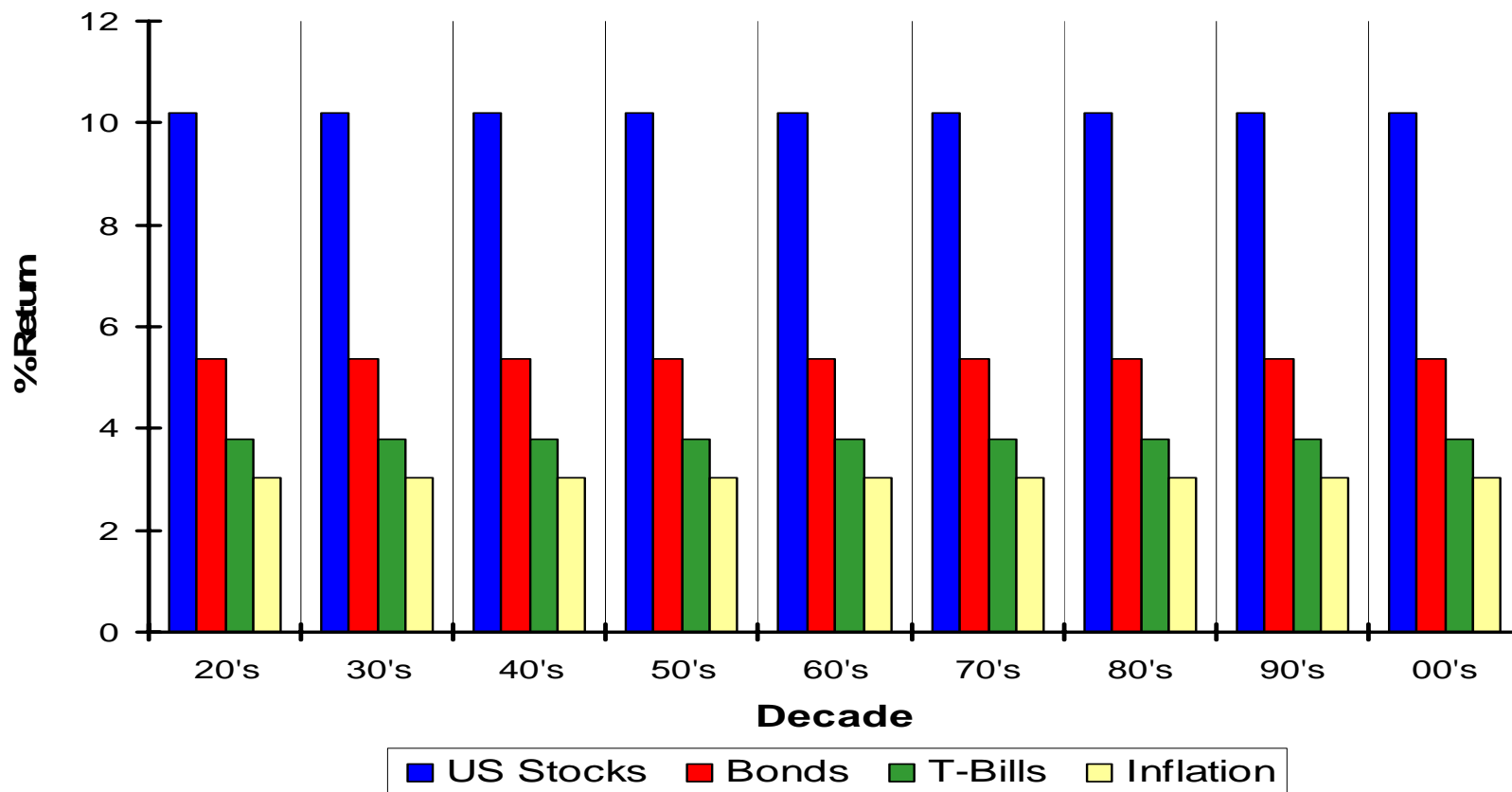
How Capital Markets Behave Over Long Periods

Annualized Compound Returns from 1926 thru 2002



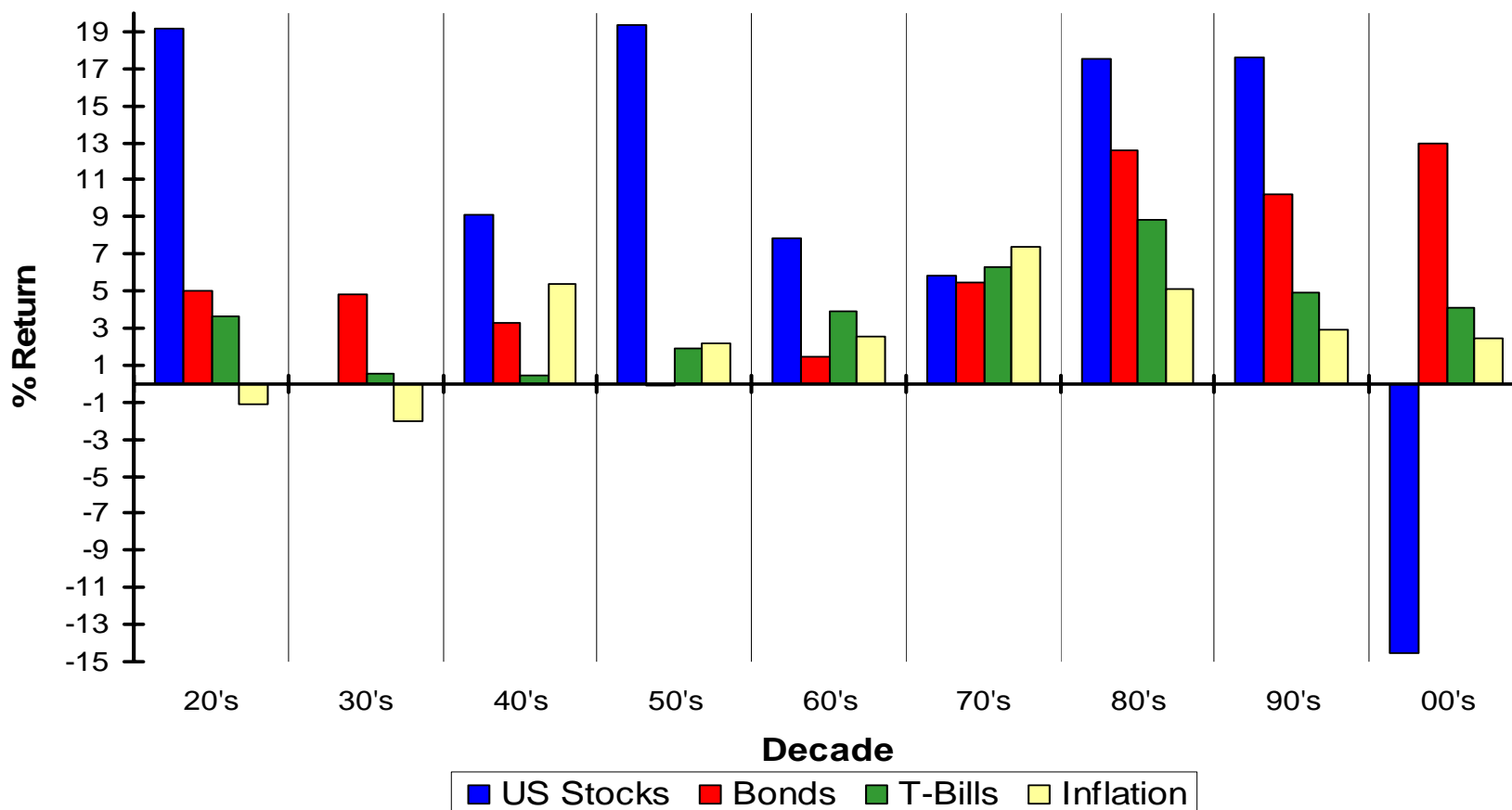
How People Perceive Markets Behaving over Time

Annual Rates of Return by Decade in Pension Paradise

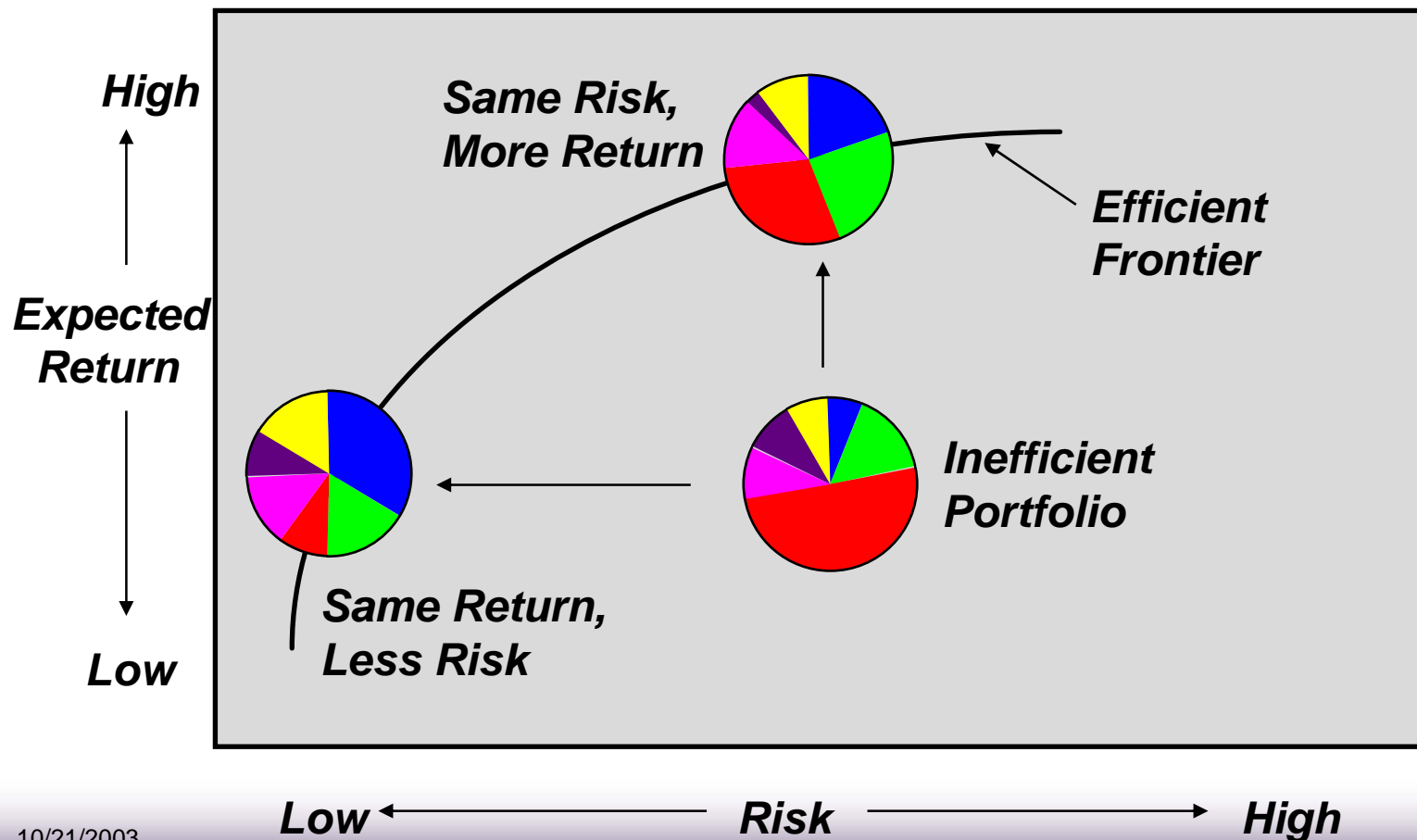


How Markets Actually Behaved Over the Decades (1926 thru 2002)

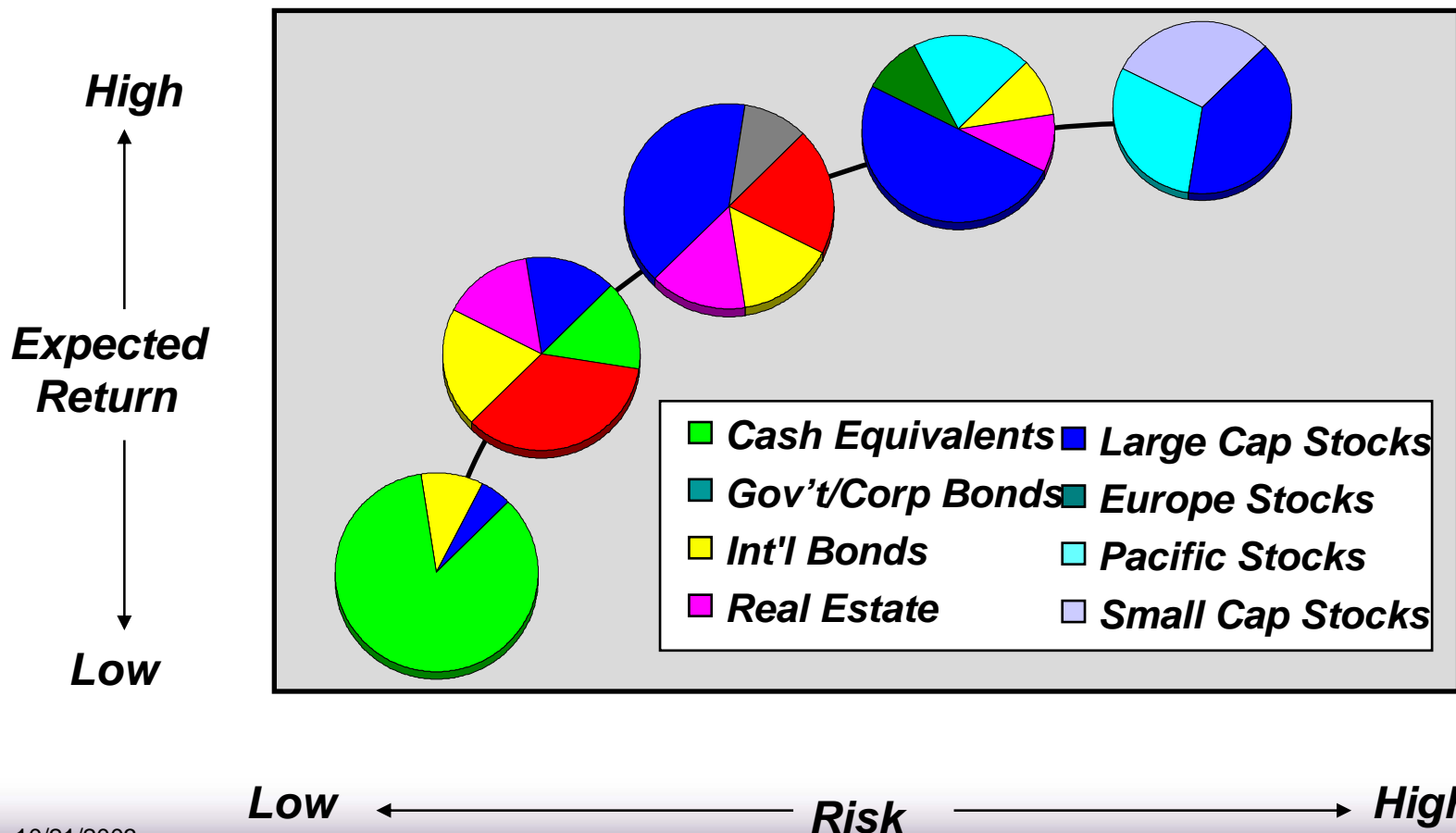
Compound Annual Rates of Return by Decade



Asset Allocation: Identifying Efficient Portfolios



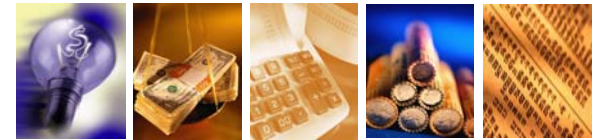
Selecting a Suitable Portfolio





Asset Allocation Process (cont.)

- Asset mix is further diversified by using different styles of investment process (growth vs. value, large cap vs. small cap, developed countries vs. emerging markets, etc.)
- 26 separate asset managers are employed for allocations ranging from \$20 to \$310 million.



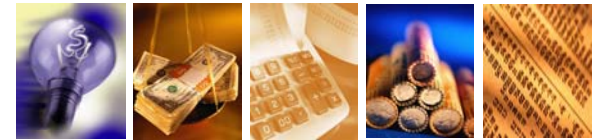
Current Asset Allocation Strategy

■ SDCERS Investment Policy Mix

- 38% Domestic Stocks
- 15% Non-US Stocks
- 32% Domestic Bonds
- 5% Non-US Bonds
- 10% Real Estate

■ Average Public Plan's Asset Allocation Mix

- 44% Domestic Stocks
- 13% Non-US Stocks
- 37% Domestic Bonds
- 1% Non-US Bonds
- 3% Real Estate
- 1 % Alternatives
- 1 % Cash

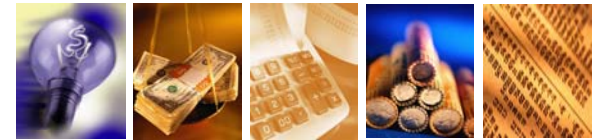


Asset Allocation Strategy (cont.)

■ Actual SDCERS Asset Allocation (\$3.007 billion as of 10-14-03)

- 39.1% Domestic Stocks
- 15.5% Non-US Stocks
- 31.9% Domestic Bonds
- 4.8% Non-US Bonds
- 8.1% Real Estate
- 0.6% Cash

SDCERS' asset allocation policy is more conservative than the average public plan with lower exposure to stocks, higher exposure to real estate and no exposure to alternatives (private equity, etc.)



Investment Performance: SDCERS vs. Other Public Funds

(PERIODS ENDING 6/30/03)

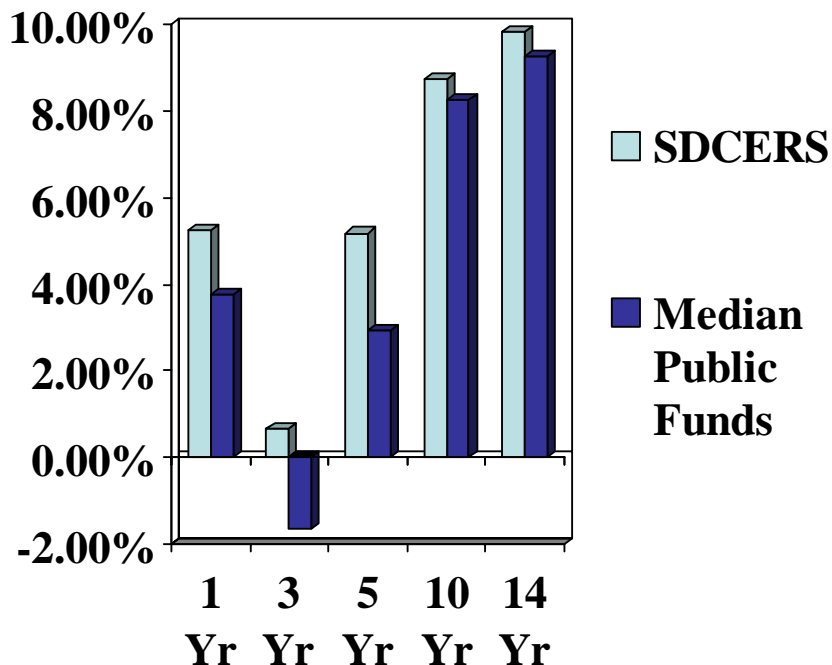
- SDCERS' one, three, five, ten and fourteen year annualized returns rank in the top 25% of public pension funds.
- For the last 24 years, the annualized rate of return has been 10.76%, exceeding the assumed 8% rate.
- Longer-term, consistent superior returns achieved with less than average levels of risk (volatility).

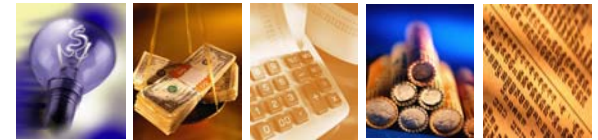


Investment Performance: SDCERS vs. Other Public Funds

(PERIODS ENDING 6/30/03)

- SDCERS outperformed other public funds over 1, 3, 5, 10 & 14 year periods with less risk.
- SDCERS achieved superior longer term results with lower than average exposure to stocks and private equity.

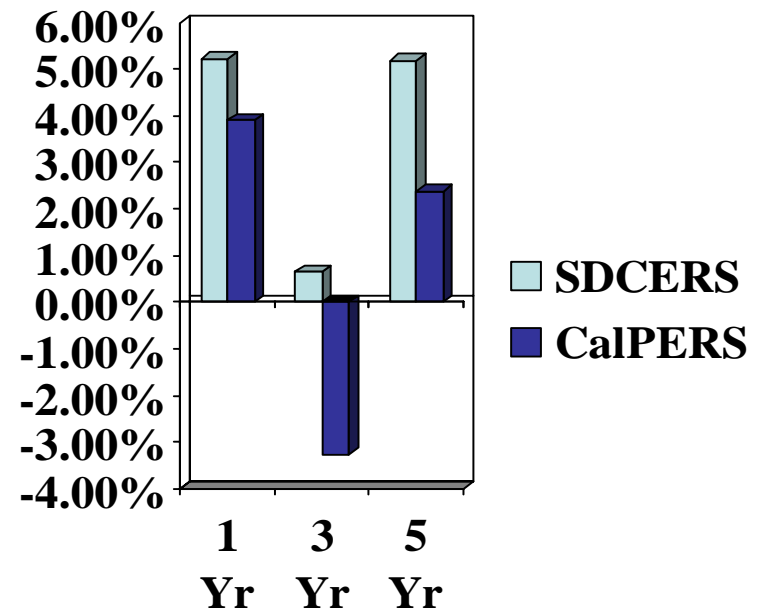




Investment Performance: SDCERS vs. CalPERS

(PERIODS ENDING 6/30/03)

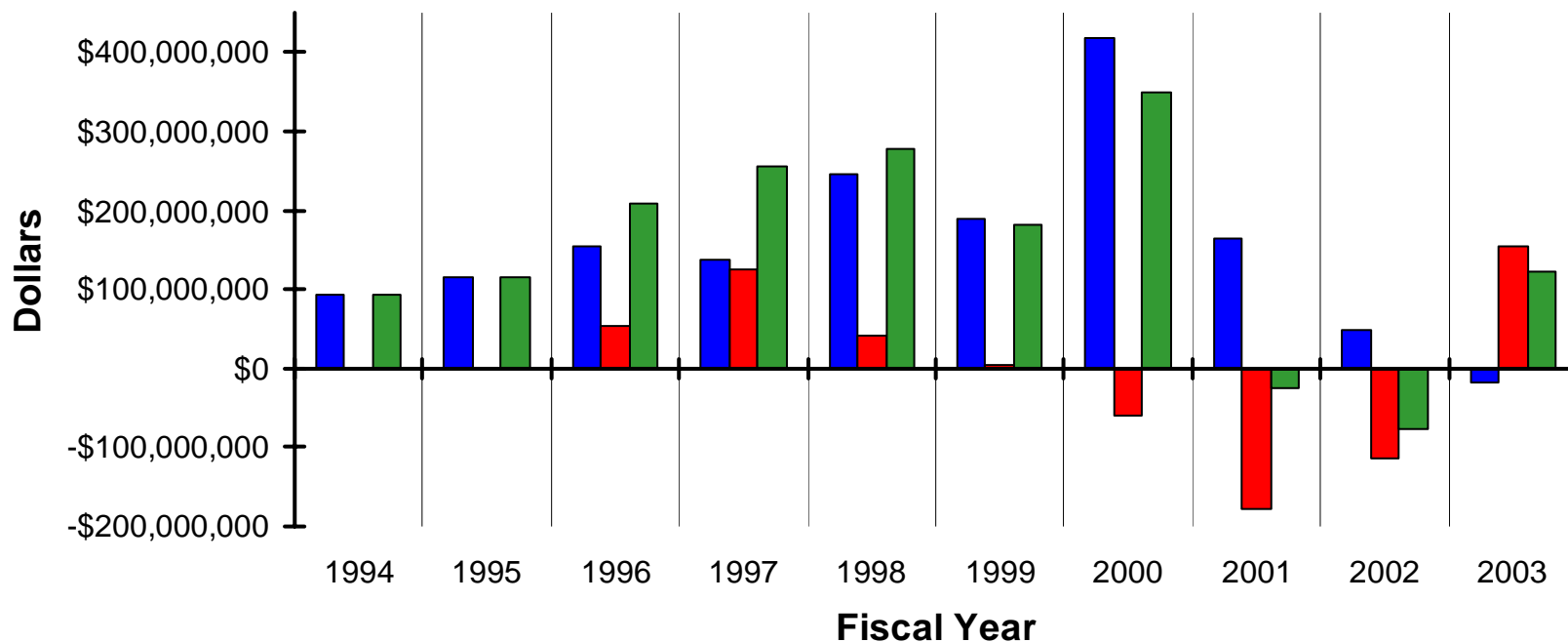
- SDCERS outperformed CalPERS over 1, 3 and 5 year periods.
- SDCERS achieved superior longer-term returns with lower risk (volatility) than CalPERS.



SDCERS Net Income by Type

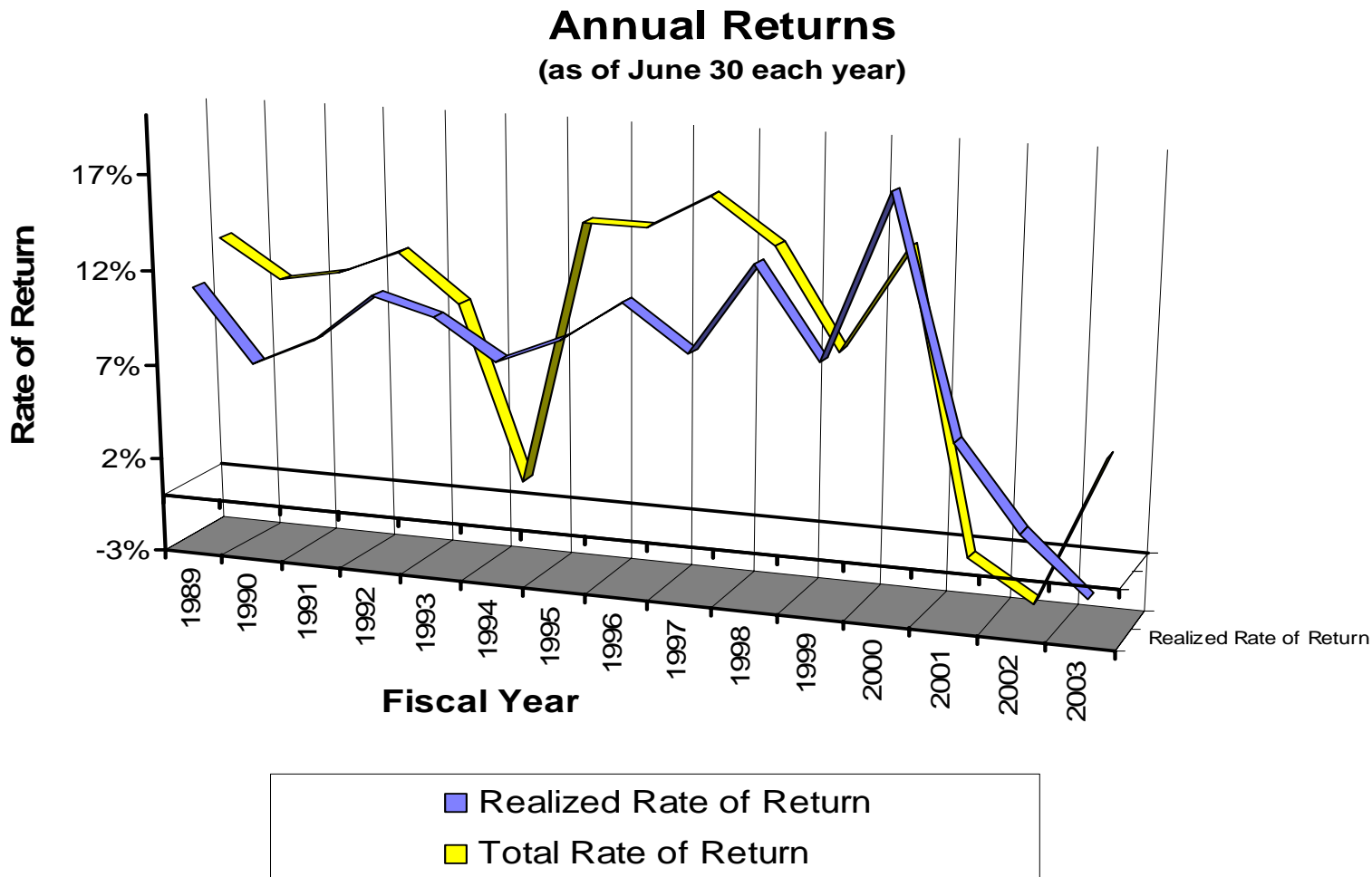
History of Net Investment Income

(as of June 30 each year)



■ Realized ■ Unrealized ■ Total Net Income

SDCERS Total & Realized Returns





Summary

- In the 24 years since March of 1979 (the earliest available quarterly return performance data), SDCERS has had an annualized rate of return of 10.76%.
- Since March of 1979, SDCERS has never had a fiscal year-ending, ten-year rolling annualized rate of return less than the actuarial assumption rate of 8%.
- Since the major restructuring of the investment program in 1989, SDCERS has delivered superior relative investment performance with less risk, resulting in lower costs to employers and employees.
- Until the worst bear market since the Great Depression, steady progress has been made toward full funding.